

## Manual Control of the Economy

After hearing the unpleasant news from the real sector that gross domestic product fell by 9.5 percent in the first quarter, we then heard more bad news from the government. First, Prime Minister Vladimir Putin declared that banks receiving assistance from federal budgetary funds must provide credit according to the rate he determines -- the refinance rate plus 3 percent. The next day, the Central Bank announced that it was lowering its refinance rate, and it did so in exact accordance with Putin's directive.

Limiting credit rates in this way is an unproductive approach because it gives the wrong stimulus to banks and borrowers. Banks could be tempted to issue credit on riskier terms -- that is, at lower percentage rates -- than usual, because the government has effectively given banks a three to one spread for carrying out their activities. Now a bank that has a bad asset, such as unpaid debt, might decide to advance more credit to the same firm at the new lower rates for one reason: to obtain additional government assistance. In theory, that money would have to be paid back, but credit is given for a one-year period and banks and politicians are living from day to day.

But even more disturbing is the Central Bank's strict obedience to the government line. It has long been clear that one of the largest problems in the economy is inflation, which will only increase after the state rejects its conservative monetary policy.

One of the most effective methods for curbing inflation is allowing the Central Bank to set its own policy, independent of political authorities. Six months ago, the Central Bank's obedience to Putin's demand for a controlled and gradual ruble devaluation cost the country's monetary reserves tens of billions of dollars. But that lesson was apparently lost.

Nothing good can come from a situation in which the government directly manages questions that are the prerogative of the Central Bank alone. It seems that the government switched over to complete "manual control" of the economy during the past year. Even before the crisis, it was evident that a number of decisions that had previously required approval from various ministers and agencies were now being made by Putin alone -- that is, by the Cabinet ministers who answer to Putin. That is why these ministers now enjoy higher status than ever before. And it explains why one particular minister, Finance Minister Alexei Kudrin, must essentially "go public" with his policies, using the mass media as a platform to warn the government about the danger of a budget deficit.

National projects and state corporations were also brought under manual control. All of the projects could have been carried out through the appropriate government agencies. But instead of making the existing structures more effective, a new "parallel" structure controlled directly by the prime minister was created. Because this new structure was freed from adherence to certain laws (such as anti-monopoly legislation) and parliamentary control, Putin had the impression that the process had become more effective. It is true that decisions can be made quickly that way, but the quality suffers. The crisis isn't the main problem. It simply makes the ineffectiveness of the current system more noticeable.

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07 May 2009

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